



Hong Kong

June 2019

HKEX TO SUSPEND LISTED ISSUERS FOR AUDIT DISCLAIMERS AND ADVERSE OPINIONS

The Stock Exchange of Hong Kong (**HKEx**) published its Consultation Conclusions on its Proposal Relating to Listed Issuers with Disclaimer or Adverse Audit Opinion on Financial Statements¹ on 24 May 2019, adopting the proposal to suspend trading in a listed issuer's securities if its preliminary results announcement carries a disclaimer on opinion or adverse opinion. The new power to suspend will be set out in Main Board Listing Rule 13.50A (GEM Listing Rule 17.49A) and will apply to issuers' preliminary annual results announcements for financial years commencing on or after **1 September 2019**, subject to the application of the transitional arrangements detailed below.

The original proposal has however been modified to address consultation respondents' concerns. The revisions include:

- Provision that trading will not be suspended:
 - i) if the disclaimer or adverse opinion relates solely to going concern; or
 - ii) the underlying issue is resolved before publication of the preliminary results announcement.
- Clarification (by way of amendment of HKEx Guidance Letter GL95-18 on long suspension and delisting) that HKEx will allow a remedial period longer than the 18 months (12 months for GEM issuers) allowed under the Listing Rules, if it is satisfied that an issuer has been

unable to resolve the issues giving rise to the disclaimer or adverse opinion, due to reasons outside of its control. The duration of the extension will be determined case-by-case.

- A 24-month transitional period will apply so that issuers will not be suspended solely for disclaimer or adverse opinions on their financial statements for the two financial years between 1 September 2019 and 31 August 2021.

Past Trading Suspensions and Auditors' Opinion in Hong Kong

Under Main Board Listing Rule 13.49(1) and (2), and GEM Listing Rule 18.49, listed issuers have a continuing obligation to publish a preliminary results announcement for the full financial year each year, not later than three months after the end of that financial year. The announcement must be based on the financial statements agreed by the issuer and its auditor. Where an auditor concludes that financial statements are not free from material misstatement (or is unable to obtain sufficient appropriate audit evidence to reach such a conclusion), it can issue one of three modified opinions as set out in the Hong Kong Standard of Auditing 705, namely a Qualified Opinion, an Adverse Opinion or a Disclaimer of Opinion.

Main Board Listing Rule 6.01 and GEM Listing Rule 9.01 give the Exchange the power to suspend or cancel the listing of listed issuers to protect investors and maintain an orderly market. New Main Board Listing Rule 13.50 and GEM Listing Rule 17.49A require a suspension of trading if the listed issuer fails to publish its preliminary annual results announcement within three months after its financial year end. An issuer would

¹ [https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/September-2018-Adverse-Audit-Opinion/Conclusions-\(May-2019\)/cp201809cc.pdf?la=en](https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/September-2018-Adverse-Audit-Opinion/Conclusions-(May-2019)/cp201809cc.pdf?la=en)

have to resolve the issue(s) behind a suspension in order for trading in its listed securities to resume. A Main Board issuer's securities may be delisted after 18 months of continuous suspension. A GEM issuer's securities may be delisted after 12 months of continuous suspension.

Proposed Listing Rule to Suspend Trading

In 2017, 43 listed issuers published audited financial statements where auditors issued disclaimers of opinion. 19 of these issuers had received disclaimer of opinion for three or more consecutive years and some disclaimers were due to material uncertainties as to the listed issuers' ability to continue as going concerns. Others were issued because sufficient appropriate audit evidence could not be obtained for a proper valuation of the issuers' assets.

HKEx's concern that some listed issuers may not be resolving audit issues promptly and adequately led to the proposed new Main Board Listing Rule 13.50A and GEM Listing Rule 17.49B. The new rules would require the suspension of trading of the issuer's securities if it publishes preliminary annual results for which the auditor has given (or indicated that it will give) a disclaimer or adverse opinion.

Listed issuers would be exempted from the trading suspension if the auditor gave the disclaimer of opinion on the results and the closing financial statements for the financial year, but the issue underlying the disclaimer on opinion had been addressed during the financial year.

Suspension of trading in a listed issuer's securities would cease after:

- i) the underlying issue behind the auditor's disclaimer or adverse opinion has been addressed;
- ii) the listed issuer has produced financial information to reflect its updated financial position; and
- iii) the auditor has provided comfort that the disclaimer or adverse opinion has been removed.

This may require a full financial year audit (or a special interim audit) of the listed issuer's financial statements or a special engagement of the auditor to audit a single financial statement (or specific element, account or item of a financial statement) of the listed issuer. To maintain the principle of keeping trading suspensions to a minimum, HKEx would be able to permit a trading resumption once the underlying issue

has been addressed, even if the auditor's disclaimer has not yet been removed, provided that its modified opinion does not detract from its assurance concerning the closing balances of the listed issuer's financial statements for the financial period following the trading resumption.

Respondents' Concerns

Concerns raised by respondents to the consultation paper included the following:

1. *Impact of suspension on minority shareholders:* some respondents expressed concerns that since suspension would take effect immediately upon publication of preliminary results announcements, shareholders would not be forewarned and would thus be unable to exit their investments before the trading suspension takes effect;
2. *Depriving shareholders of ability to trade:* some respondents noted the complexity of many audit issues and raised concerns that if these take time to be resolved, resulting in a prolonged trading suspension, the issuer's shareholders would be prevented from trading the securities during the suspension period;
3. *Adequacy of current regime:* others opined that the existing disclosure-based and post-vetting regime provides a transparent market by requiring issuers to disclose material issues in a timely manner, while HKEx retains the right to suspend or cancel the listing of an issuer to protect investors and/or maintain an orderly market;
4. *Proposal out of line with other markets:* it was noted by some that the proposal was out of line with the requirements of other markets, and that the mandatory trading suspension requirement previously applicable to Mainland China-listed A-share companies was abolished in 2018 and replaced by disclosure-based rules. Others suggested following UK market practices;
5. *Delayed suspension period:* some respondents suggested allowing time for resolution of the audit issues before implementing a suspension, for example a grace period of six months;
6. *Financial hardship for issuers:* concerns were raised that suspension could cause issuers to default on bank loans, bonds and notes and generally negatively impact their financial position, particularly in the case

of financially distressed companies with going concern issuers since their ability to raise funds from investors would be affected. These respondents suggested that mandatory suspension should apply only to cases where the disclaimer or adverse opinion is solely due to a going concern issue;

7. *Issues beyond the issuers' control:* examples of situations where the underlying audit issues resulting in a disclaimer or adverse opinion were considered to be beyond the issuer's control included: (a) litigation and disputes on a significant asset or contract, or income; (b) deconsolidation of subsidiaries and incomplete or missing books and record due to uncooperative or unreachable management; (c) funding shortage due to poor market sentiment; and (d) failure to obtain audit confirmation or evidence of recoverability of receivable debtors;
8. *Insufficiency of remedial period for issue resolution:* there were concerns that the proposed period of 18 months (12 months for GEM issuers) would not be sufficient for issuers to resolve audit issues given the typical complexity of these issues. The respondents were concerned that a delisting resulting from an issuer's inability to resolve the relevant issues within the suggested timeframe would deprive investors of their ability to sell their shares;
9. *Concerns related to the delisting regime:* concerns were raised in relation to the delisting regime for listed issuers, the consultation conclusions for which were published in May 2018.

Alternative Proposals

A number of alternative proposals were suggested including that:

- rather than triggering a suspension, HKEx could add a suffix to the stock short name to identify issuers with disclaimer or adverse opinions to alert investors of the associated investment risk;
- trading should be allowed to continue for one month between the publication of the preliminary results announcement and the annual report.
- given that management is often aware that a disclaimer or adverse opinion will be made well in advance of publication of the issuer's preliminary results,

issuers should be required to inform the market to allow shareholders to exit their investment prior to the commencement of the suspension period;

- HKEx should instead have a discretion on a case-by-case basis to suspend trading in the securities of particular issuers since it could be unfair to suspend trading in securities in circumstances which do not involve any irregularities or misconduct on the part of the issuer;
- trading should resume once an issuer put forward a concrete plan to address the audit issues; and
- HKEx should implement a separate over-the-counter market for trading suspended and delisted securities, or allow special or restrictive arrangements to enable a restricted group of investors to trade suspended shares and to enable minority shareholders to sell their shares to those investors.

The modified proposal

Given the concerns raised by respondents, HKEx has revised the proposed rule so that it will not apply where:

- i) the disclaimer or adverse opinion relates solely to going concern; or
- ii) the underlying issue giving rise to the audit modification has been resolved before the issuer publishes its preliminary results announcement.

Modified remedial period

Under the current HKEx Listing Rules, a Main Board issuer's securities may be delisted after 18 months of continuous suspension and a GEM issuer's securities can be delisted after 12 months of continuous suspension. In response to concerns that it would be unfair to delist an issuer because of an adverse opinion or disclaimer which is due to issues beyond the issuer's control, HKEx will modify the remedial period. It proposes to amend the guidance letter on long suspension and delisting (HKEx GL95-18) to clarify that if the issuer satisfies HKEx that it has made all reasonable efforts to resolve the issues giving rise to the disclaimer or adverse opinion but, due to reasons outside of its control, such underlying issues remain unresolved, a longer remedial period will be considered, with the duration of the extension to be determined on a case by case basis. The examples of circumstances which would be considered to be beyond an issuer's control include: (a) a delay

in government granting a requisite approval due to change in government policies; (b) a temporary suspension of business upon request of a regulatory or government authority due to changes in regulatory requirements; and (c) where the audit issue can only be completely resolved by a court order or final arbitral award with respect to outstanding proceedings.

Effective date and transitional arrangements

New HKEx Listing Rule 13.50A (GEM 17.49B) will apply to issuers' preliminary annual results announcements for financial years commencing on or after 1 September 2019.

A transitional arrangement (Main Board Listing Rule 13.50B, GEM Listing Rule 17.49C) has been added to extend the remedial period to 24 months for both Main Board and GEM issuers that are suspended solely due to a disclaimer or adverse opinion being issued in the first two financial years after the implementation of the new Listing Rule 13.50A (GEM 17.49B). The remedial period will apply to issuers suspended solely due to disclaimer or adverse opinions on their financial statements for the financial years commencing on or after 1 September 2019 and up to and including 31 August 2021. The revised transitional period is aimed at giving issuers time to review and improve their internal controls and risk management practices.

Issuers with current disclaimers or adverse opinions on their financial statements

Issuers whose financial statements are currently subject to a disclaimer or adverse opinion will not be required to suspend trading under new Listing Rule 13.50A unless they receive further disclaimers or adverse opinions for their financial statements for financial years commencing on or after 1 September 2019 and the issues giving rise to the audit modifications remain unresolved.

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